The Reformed SSA Trader: New Year's Exclusions

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In what appears to be a failed attempt to fly under the radar, SSA[1] bond issuer Japan Bank for International Cooperation (JBIC) announced on 29 Dec that they will fund the Vietnamese Vung Ang II coal power plant build out. They clarified the funding linkage of another significant SSA issuer, Export-Import Bank of Korea (KEXIM/EIBKOR) to the project as well.

Thus, in this first issue of 'The Reformed SSA Trader', we put JBIC and KEXIM bonds on our climate investment exclusion list. Buying JBIC and/or KEXIM bonds is effectively funding coal incineration through Vung Ang II and should not be part of a climate aligned SSA portfolio. Of particular concern is the KEXIM €700mn green bond issued in April, 2020 (EIBKOR €0.829 04/25).

We do not believe in nursery tales of this funding being for some sort of economic development for Vietnam. In our opinion, this is industrial subsidization policy for ailing domestic South Korean and Japanese coal 'technology' businesses, using Vietnam for taking the actual carbon emissions hit.

Our SSA climate exclusion list in Table 1 is so far rather short and exclusive, but we fear it will grow as we analyse the sector further, and as the corporate bond market rejects direct financing of coal/oil sand issuers and alternative funding routes are sought.

The issuers are assigned ECOBAR scores[2] of 9, and scores of 1 for short/underweight positions.

Table 1. AFII Reformed SSA Trader climate exclusion list as of January 6, 2021.

Issuer	Ticker	Sample ISIN	Rating	EUR/USD outstanding	Reason	References
Government of Queensland (AUS)	QTC	QTC A$1.25% 03/31 AU3SG0002371	AA+	USD0.8bn	Coal infrastructure greenwashing.	Dalrymple of Queensland and the Mighty Greenwash and Reef Credits
Province of Alberta (CAN)	ALTA	ALTA €0.5% 04/25 XS2156776309	AA-	USD20.5bn	Oil sand financing	The ECB and Alberta's oil production tax holiday.
Export Development of Canada	EDC	EDC $1.375 10/21 US30216BGK26	AAA	USD20.8bn	Oil sand financing, (greenwashing).	See below.
Japan Bank for International Cooperation	JBIC	JBIC $2.125% 04/25 US471048AM01	A+	USD4.6bn	Coal plant financing.	See below.
Export-Import Bank of Korea (KEXIM)	EIBKOR	EIBKOR €0.829 04/25 XS2158820477	AA	USD34.3bn	Coal plant financing, greenwashing.	See below.

[1] Supras, Sovereigns and Agencies bond sector, further explained below.
[2] ECOBAR is a trading focused carbon risk model, see "Credit alpha and CO2 reduction: A portfolio manager approach", 19 Jun 2017, SSRN working paper, and "Low carbon credit performance: A 2020Q3 update", 13 Oct 2020, Anthropocene Fixed Income Institute.

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What are SSAs?

Supras, Sovereign and Agencies (SSAs) refers to a diverse set of issuers which one could broadly define as any bond that are issued neither by a corporate or a sovereign in its own domestic currency (pure government issuer). This includes multilateral banks such as the World Bank, sub-government development finance institutions such as German KfW, straight bond issuance (not mortgage backed) from agencies such as Fannie Mae, bailout facility financing such as the European Stability Mechanism (ESM), subgovernment financing such as Government of Queensland. It is usually understood as including covered bonds which is a key funding source for European banks in a semi-asset-backed format. Sovereign issuance in non-home currency, such as Kingdom of Sweden issuance in USD, is the reason for the "Sovereign" part of SSA.

SSA bonds are usually very highly rated. Some investors even refer to their SSA portfolios as the "AAA" portfolios, which historically used to be fairly accurate but is less so today. There are often explicit or implicit government guarantees for the issuers which makes the trading dynamics of SSA bonds sensitive to political headlines, as illustrated in Figure 1. Most of the time though, SSA bonds are quite boring to trade.

Figure 1. Norwegian SSA issuer Eksportfinans had their explicit government guarantee revoked in the fall of 2011 and were downgraded with a commensurate bond price fall of almost 30%.

The SSA space in fixed income is neither well-known or -analysed out of a climate risk and impact perspective, despite the large-scale funding of such entities in terms of both green bonds as well as fossil funding. To be frank, it is an extremely conservative sector. But SSAs play a big role in institutional fixed income portfolios as well as other liquidity portfolio among private and central banks, for example as collateral. AFII has for example earlier argued that the SSA issuer Province of Alberta's bond should not be allowed into the European Central Bank's collateral facilities.

This article is a starter from AFII's side to cover the space, based on our experiences both from managing SSA portfolios in general and climate risks in particular. We believe a bare minimum of climate awareness in terms of managing SSA bond portfolios should result in at least some sort of exclusion lists: buying some SSA bonds is effectively funding some of the worst tail risks in terms of fossil projects, alternatively lending credence (and capital) some of the more egregious greenwashing efforts in the marketplace.

The list in Table 1 is obviously not an exhaustive list, but AFII believes it to be essential to point out the extremes as the start of a process of broader climate awareness. We focus on USD and EUR bond issuance as this will be traded on a global basis. We use a number of discretionary criteria for the list,

Japan Bank of International Development/KEXIM

In order to avoid any misunderstanding, we quote from the JBIC's home page:[3]

*" The Japan Bank for International Cooperation (JBIC; Governor: MAEDA Tadashi) signed on December 28 [2020] a loan agreement with Vung Ang II Thermal Power Limited Liability Company (VAPCO), a Vietnamese company invested in by Mitsubishi Corporation and others. JBIC will provide project financing[*1] amounting to up to approximately USD636 million (JBIC portion) for the Vung Ang 2 coal-fired power plant in the Socialist Republic of Viet Nam (Vietnam), under JBIC's Growth Investment Facility[*2]. The loan is co-financed with private financial institutions as well as the Export-Import Bank of Korea (KEXIM). The total co-financing amount is approximately USD1,767 million.*

• In this project, VAPCO will build, own, and operate an ultra-supercritical coal-fired power plant with an installed capacity of 1,200MW (two units of 600MW each) in the Vung Ang district, Ha Tinh province in central Vietnam. The electricity generated from this plant will be sold to Vietnam Electricity (EVN), the country's state-owned power utility company, for 25 years."

To clarify, JBIC will contribute USD636 million, whereas the exact KEXIM amount is not clear.[4] The KEXIM financing is clearly part of a package to allow South Korean private companies to build the plant. This is the reality for investors in KEXIM bonds: you are lending money in order for South Korea companies to win orders to deliver coal-based turbines and construction.[5] In the same vein, JBIC financing appears to be opportune for Mitsubishi Corporation.

The lending decisions of these institutions are taken with full awareness of what they entail climate-wise and we cannot do anything but suggest that investors buying JBIC and KEXIM bonds are contributing capital to climate destruction. They should be excluded from a climate aligned SSA portfolio.

We add a greenwashing[6] label to KEXIM's green bonds as well. Following the discussion around the Queensland government (QTC) green bonds, we opine that an issuer cannot simultaneously fund new coal projects and claim to be 'green' even under conditions of fully asset-backed structures (which is not the case here). Of particular worry in this context is the EIBKOR €700mn 0.892 04/20, issued as late as in April 2020.[7] It seems fairly likely that EIBKOR was aware that it would be financing the Vung Ang II plant at the time of issuance. But we are unaware of whether this was disclosed to potential green bond investors or not. Maybe the syndication banks or the second opinion provider has a clearer view on that.

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[3] "Project Financing for Vung Ang 2 Coal-Fired Power Generation Project in Vietnam", JBIC homepage, 29 Dec 2002. For a critique of the Vung Ang II project, see for example "Vung Ang II coal power plant", Bank Track, accessed 2 Jan 2021.

[4] We note that Korean Electric Power Company (KEPCO) is investing USD190mn in the project.

[5] Please refer to "KEPCO set to finance $190mn for Vietnam's coal power plant project", Korea Economic Daily, 5 Oct 2020. The article explicitly mentions Samsung C&T and Doosan Heavy Industries as participants in the project.

[6] We use a bankruptcy-risk-perspective on the greenwashing concept. Green bond financing that in case of the issuer's bankruptcy clearly can be used to cover losses of its (significant) new coal or oil sands projects is a greenwash in our opinion.

[7] See for example BNP Paribas coverage of the KEXIM green bond issuance, 29 Apr 2020, link.

We also leave open the question if KEXIM's credit line to Carmichael (potential) lender State Bank of India[8] is still active, in which case it could be potentially a provider of capital to that coal project as well.

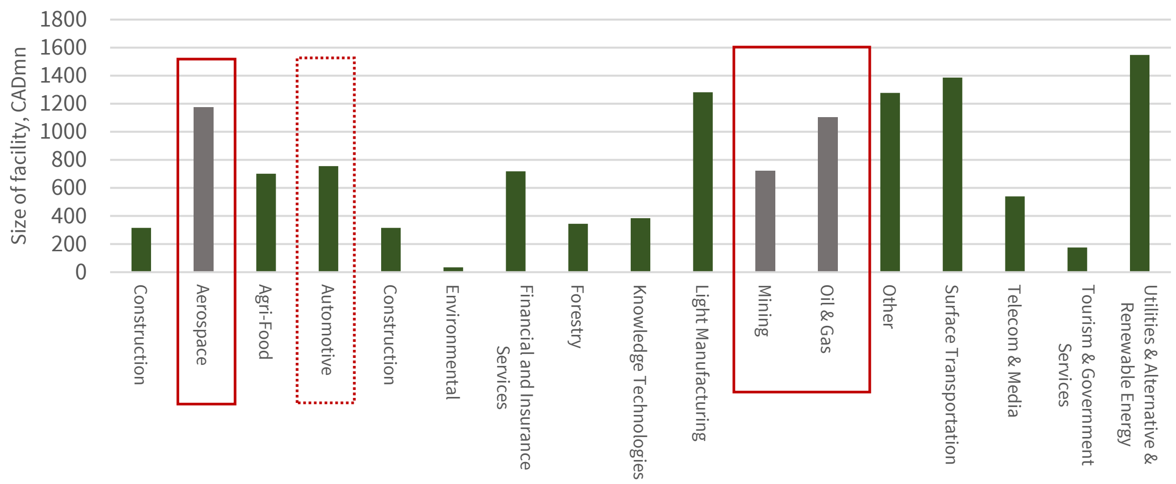
Export Development of Canada

Export Development Canada (EDC) provided a scarring example of green bond use of proceeds with their green bond EDC $1.25 12/18, issued in 2015 and now matured. One of the use of proceeds was restitutions of sites where oil sands had been extracted. There are no gold stars awarded for guessing what the AFII's position would be on that, nor what it was at the time when we saw the bond from a portfolio management perspective.

More recently, EDC have appeared to be instrumental in pipeline building in North America.[9] Indeed, when we summarize EDC's sectoral exposures, as in Figure 2, the fossil exposure come across as quite strong. Please note that the sectoral stratification is not exact, there appears to be a fair amount of cross-overs between mining and oil and gas. Around 25% of EDC's exposure thus appears to be related to severely carbon intensive sectors even without further diving into the Automotive and Utilities sectors. **We thus claim that EDC's aim in terms of providing credit is well aligned with further divergence from the Paris targets and buying their bonds in turn aligns with that strategy.**

Finally, we must confess that we are impressed by EDC's non discriminative approach to extending financing: giving credits to oil company Gangster Enterprises Ltd. must certainly require a very objective - if unimaginative - approach.

Figure 2. Export Development Canada sectoral credits/guarantees, July 2019-Dec 2020. Estimates based on EDC indicative numbers. Excludes joint guarantees with US Export Import agency and for financial institutions. Source: EDC and AFII calculations.



[8] See Korea Exim bank and SBI sign agreement to increase credit line to USD1bn, 13 Jan 2016, KEXIM press release.

[9] See for example "Canadian Gov's EDC set to 'invest' in controversial Coastal Gaslink pipeline", 21 Feb 2020, Oil Change International.

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Academic/technical papers

"The Green Bond Risk Premium: A Twin-Bond ULFP Approach", SSRN working paper, Jul 2020. Link.
"Credit alpha and CO2 reduction: A portfolio manager approach", SSRN working paper, May 2017. Link.

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